CABOT MICROELECTRONICS CORPORATION
SECOND QUARTER FISCAL 2018 CONFERENCE CALL SCRIPT
April 26, 2018

Good morning. My name is Colleen Mumford, and I am Cabot Microelectronics' new Investor Relations Director. I have worked at CMC for over twenty years in various roles, including R&D, Quality and Human Resources. I am excited to be in this role as we report our second quarter results, and I look forward to working with you in the future.

With me today are David Li, President and CEO, and Scott Beamer, Vice President and CFO.

This morning we reported results for our second quarter of fiscal 2018, which ended March 31, 2018. Whether you're joining us online or over the phone, we encourage you to review the investor presentation that we've made available under the Investor Relations section of our website, cabotcmp.com. We made these slides available at approximately the same time as the issuance of our earnings release this morning.

A webcast of today's conference call and the script of this morning's prepared comments will also be available on our website shortly after this live conference call. You may also request any of the information by calling our investor relations office at 630-499-2600.

Please remember that our discussions today may include "forward-looking statements" that involve a number of risks, uncertainties and other factors that could cause actual results to differ materially from these forward-looking statements. These risk factors are discussed in our SEC filings, including our Form 10-K for the fiscal year ended September 30, 2017. We assume no obligation to update any of this forward-looking information.

Also, our remarks this morning reference non-GAAP financial measures. Our earnings release includes a reconciliation of GAAP to non-GAAP financial measures.

I will now turn the call over to Dave.

Thanks, Colleen. Good morning, everyone, and thanks for joining us.

This morning we announced another quarter of very strong financial performance, including record quarterly revenue, net income, and earnings per share. This is the fourth consecutive quarter in which we have reported record revenue, which we believe demonstrates the continued strong execution of our strategic initiatives complemented by robust industry demand.

Scott will provide additional details about our financial results later in the call.

Let me start by providing some details on the current operating environment and our view of global semiconductor industry demand. During the March quarter, industry demand remained strong, particularly in the memory segment, where our customers continued their migration to 3D NAND. We currently estimate that approximately 50% of 2D to 3D NAND wafer capacity conversion has occurred, with the remainder expected to be completed over the next several years. We also have seen continued capacity expansions in 3D NAND underway, primarily in Korea and China, which along with the expected tight supply of DRAM memory, should provide growth opportunities for us in the future.

In the advanced logic and foundry segments, we have seen our customers' growth moderating a bit as they get past the traditional stronger periods associated with new smartphone launches. However, we continue to work closely with our customers to help them advance to smaller feature sizes, and believe that new applications in mobile, artificial intelligence, autonomous vehicles and blockchain should continue to drive demand for advanced logic semiconductors in the future.

Finally, we continue to see a robust demand environment in the legacy logic and foundry segment driven by automotive, internet of things, and industrial automation. We expect this demand environment to persist given the increasing connectivity requirements needed in these important applications.

Now let me turn to company-related matters. This quarter we recorded strong results in all three key product areas; tungsten slurries, dielectrics slurries, and CMP pads, primarily due to strong demand across a wide range of applications and technology nodes.

Geographically, all regions were up this quarter compared to the same quarter last year; most notably, revenue in Korea was up approximately 65% year over year, primarily due to our strong positions in the growing memory market in that region.

Turning to performance by product area, revenue in our tungsten slurries was 17% higher than in the same quarter last year. This growth was driven by the ramp of our customers' advanced technologies in memory and logic, including 3D NAND and FinFET. As mentioned earlier, we expect the memory area to remain strong, and 3D NAND expansion to continue into the second half of this fiscal year and beyond.

In addition, during this quarter we achieved record revenue from our dielectrics slurries. This was primarily driven by increased demand and the benefit of customer wins for our ceria based solutions at advanced memory customers. We continue to see a bright future for our refreshed portfolio of dielectrics products in memory, logic, and foundry, and believe we are well positioned to continue growing revenue while also improving profitability of this product area.

Turning to CMP pads, this quarter we also achieved record revenue. We are focused on capacity expansion and driving excellence throughout our supply chain to support our customers in both advanced and legacy applications. In addition, we are seeing increased rate of adoption at major advanced memory customers due to the lower defectivity performance benefits of our NexPlanar technology. We believe the combination of our technology, global technical support, and the shorter qualification times we have experienced with our NexPlanar pad solutions combined with strong customer interest will keep us on the trajectory of our goal to grow our pads revenue to over $100 million in fiscal 2019.

I am also pleased to report that during the quarter we were awarded a Perfect Quality Award from ON Semiconductor, a leading supplier of semiconductor-based solutions primarily focused on automotive, communications, and computing applications. CMC has received this award for three consecutive years, which demonstrates our ongoing commitment to supply high quality, robust CMP solutions that enable our customers to advance their technology in the growing areas of the semiconductor industry, including automotive.

Also of note this quarter, in March, we announced plans to collaborate with Fujimi Incorporated in the development of certain advanced IC CMP solutions for the semiconductor industry. We believe that by working together we can leverage our respective expertise to meet and exceed customer requirements for innovative IC CMP solutions for an increasing number of advanced semiconductor applications. I am delighted with the opportunities this initial collaboration is designed to provide for our customers and respective companies. Fujimi Incorporated and Cabot Microelectronics are both leaders in materials development, with a track record of providing high quality, leading edge IC CMP solutions to our customers. Together, I believe we are even better positioned to develop advanced IC CMP solutions for the semiconductor industry.

Finally, this quarter we also announced our refreshed capital deployment program, which includes the doubling of our quarterly cash dividend as well as a commitment to returning at least 50% of our annual free cash flow to our shareholders. We believe this refreshed strategy demonstrates our confidence to continue profitably growing our business, as well as our commitment to returning additional value to our shareholders.

Looking ahead, we feel confident about our ability to continue delivering on our long term financial goals of growth faster than the industry, and margin expansion. Although recent reports suggest that industry growth may be beginning to moderate, especially in the logic and foundry areas, we believe our business model, which is primarily based on wafer starts, will allow us to continue to profitably grow. As a result, we currently expect third fiscal quarter revenue for our IC CMP consumables business to increase by low to mid-single digits compared to this quarter.

I am confident of the continued momentum in our three key product areas, which we believe provide the foundation for profitable growth for our company. We remain focused on delivering innovative, high-performing and high-quality CMP solutions to our global customers. We believe our global resources, infrastructure, and quality and supply chain excellence continue to differentiate us among leading suppliers of specialty materials to the semiconductor industry, and position us well to deliver another year of strong performance.

And with that, I will turn the call over to Scott for more detail on our financial results.

Thanks, Dave, and good morning everyone.

My comments will generally follow the related slide presentation we posted on our website this morning.

Let’s start with an overview of our financial performance this quarter, which is provided on slide 3.

Revenue for the second quarter of fiscal 2018 was a record $143 million, which is approximately $24 million, or 20% higher than the same quarter last year. The increase reflects continued strong global semiconductor industry demand and our focus on our three key product areas.

Sequentially, revenue increased $3 million, or approximately 2%, which is in line with the expectations shared on our previous conference call in January and at our Annual Meeting in March. This is notable since the March quarter has traditionally been a seasonally softer quarter for us.

Our Net Income of $29.7 million was also a record, and represented an increase of $11.5 million, or approximately 63%, over the same quarter last year driven by higher revenues and increased gross margin. Non-GAAP Net Income was $31.3 million.

Dave mentioned our previously announced capital deployment program and research collaboration with Fujimi. Later, I will elaborate on the capital deployment program.

Now let's drill down into revenue, which is shown on slide 4.

As previously stated, we define tungsten slurries, dielectric slurries and polishing pads as three key product areas that are strategically important to us. During the quarter, these accounted for approximately 80% of total revenue, and I'll mention each in order:

Tungsten revenue was $60 million, an increase of approximately 17% compared to the same quarter last year.

Dielectrics slurries delivered record revenue of $35 million, up approximately 24% from the same quarter a year ago.

Sales of polishing pads delivered record revenue of $21 million, up approximately 23% compared to the same quarter last year.

Sales of slurries for polishing metals other than tungsten, including copper, aluminum and barrier, represented $17 million, and increased approximately 15% from the same quarter last year.

Finally, revenue from our Engineered Surface Finishes products, which includes QED, Data Storage, Electronic Substrates, and Surface Finishes, was $10 million. During the quarter, we divested our Surface Finishes business, which did not have a material impact on our second quarter financials.

Now please refer to slide 5, which provides some higher-level P&L comparisons.

Gross margin for the quarter was approximately 52.5%, compared to 50.4% in the same quarter a year ago. Excluding $1.3 million of amortization expense related to the NexPlanar acquisition, gross margin was approximately 53.4%. Higher sales volume and a higher valued product mix were positive, but were partially offset by higher fixed manufacturing costs, including higher incentive compensation expense.

Year to date, gross margin was approximately 52.7%, compared to 50.1% last year. We now expect our GAAP gross margin for the full fiscal year to be between 51% and 53%, increasing our guidance from the prior expectation. This includes an adverse impact of approximately 100 basis points related to NexPlanar amortization expense.

Operating expenses, which include research, development and technical, selling and marketing, and general and administrative costs, were $38.0 million this quarter, an increase of $1.9 million over the same quarter a year ago. This primarily reflects higher incentive compensation and annual merit increases. As a percent of revenue, our operating expenses *declined* to 26.5% compared to 30.3% in the second quarter of fiscal 2017.

Our operating margin was 25.9% in the quarter, an increase of 580 basis points from the same quarter last year. This increase was driven by higher gross margin and prudent control of operating expenses.

Diluted EPS was $1.14 this quarter which represents an increase of approximately 61% over the prior year quarter. Diluted EPS on a non-GAAP basis was $1.19. This was primarily driven by higher revenue and higher gross margin.

Now please refer to slide 6, which provides balance sheet and cash flow information.

We generated cash flow from operations of $36.5 million. We ended the quarter with a cash balance of $461 million and $138 million of debt outstanding. We paid off this debt in April.

Capital spending for the quarter was $4.6 million, bringing our year to date total to $8.8 million.

Accordingly, our free cash flow was $31.9 million in the quarter.

Let me provide a few reminders about our Capital Deployment program.

As we reported in March, our Board of Directors declared a quarterly cash dividend of 40 cents per share on our common stock, representing a 100% increase over our previous quarterly cash dividend, and an annualized rate of $1.60 per share, or approximately $40 million in aggregate. This represents approximately one third of our fiscal 2017 free cash flow of $120 million.

We also announced our intention to distribute at least 50% of our prior fiscal year free cash flow to our shareholders on an ongoing basis through a combination of cash dividends and share repurchases. This combination would represent at least $60 million to be paid in fiscal year 2018. We believe the increase in our regular quarterly cash dividend and our stated intention to distribute at least one-half of our free cash flow allows us to return a meaningful amount of capital to shareholders, while also affording flexibility to execute M&A that leverages our core capabilities.

As a reminder, our capital deployment priorities remain, investing in the organic needs of our business, paying dividends, executing mergers and acquisitions in related areas, and repurchasing shares. As of March 31, 2018, we had approximately $115 million of authorization remaining under our existing share repurchase program.

Separately, the passage of the U.S. Tax Cuts and Jobs Act facilitated our repatriation of approximately $200 million in overseas cash and short-term investments. We executed this in April and used some of this cash to pay off our term loan. As a result, we expect to save approximately $4 million in interest expense on an annualized basis.

We provide some closing remarks on slide 8.

From a financial perspective, we achieved strong performance in our fiscal year 2018 second quarter. Revenue increased $24 million from the prior year, while operating income increased $13 million, implying that approximately 54% of our incremental revenue dropped directly to operating income.

Finally, in the appendix on slide 9, we provide a table showing the updates to certain expectations. As we think about the second half of fiscal 2018, at present we expect continued solid industry demand. With that said, and as Dave mentioned, we currently expect fiscal third quarter revenue for our IC CMP consumables to show a low to mid-single digit increase compared to our second quarter.

As stated, we are raising our full fiscal year gross margin guidance to 51% to 53%. We intend to continue to manage our operating costs to provide strong operating leverage and net income growth.

We now expect our operating expenses for the full fiscal year to be between $148 and $153 million, an increase from the prior range. This increase allows us to support additional revenue and primarily reflects higher incentive compensation and annual merit increases.

Our effective tax rate for this fiscal quarter was 19.6%, and we continue to expect our effective tax rate for the remaining quarters to be between the range of 21%-24%. Our capital spending expectation for the full fiscal year remains between $18 and $22 million.

Now I'll turn the call back to the operator, as we prepare to take your questions.

That is all the questions we have this morning. Thank you for your time and your interest in Cabot Microelectronics.